

EXCEPTION

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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

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Chairman

JIM IRVIN

Commissioner

WILLIAM A. MUNDELL

Commissioner

DOCKETED

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IN THE MATTER OF THE APPLICATION OF ) DOCKET NO. E-01933A-98-0471  
TUCSON ELECTRIC POWER COMPANY FOR )  
APPROVAL OF ITS STRANDED COST )  
RECOVERY AND FOR RELATED APPROVALS, )  
AUTHORIZATIONS AND WAIVERS. )

IN THE MATTER OF THE FILING OF TUCSON ) DOCKET NO. E-01933A-97-0772  
ELECTRIC POWER COMPANY OF )  
UNBUNDLED TARIFFS PURSUANT TO A.A.C. )  
R14-2-1602 *et seq.* )

IN THE MATTER OF THE COMPETITION IN ) DOCKET NO. RE-00000C-94-0165  
THE PROVISION OF ELECTRIC SERVICES )  
THROUGHOUT THE STATE OF ARIZONA. ) EXCEPTIONS TO PROPOSED  
STRANDED COST ORDER

On October 26, 1999, the Arizona Corporation Commission's ("Commission") Chief Hearing Officer issued a Proposed Order regarding the Settlement Agreement that was entered into between Tucson Electric Power Company ("TEP" or "Company") and various parties relating to the Company's stranded costs and unbundled distribution tariffs. Pursuant to A.A.C. R14-3-110.B, TEP, through undersigned counsel, hereby submits the following Exceptions to the Proposed Order.

I. INTRODUCTION.

Pursuant to Commission Decision No. 61677, TEP filed a Settlement Agreement dated June 9, 1999 ("Settlement") between TEP, Arizonans for Electric Choice and Competition ("AECC")<sup>1</sup>,

<sup>1</sup> AECC is a coalition of energy consumers in support of competition and includes Cable Systems International, BHP Copper, Motorola, Chemical Lime, Intel, Honeywell, Allied Signal, Cyprus Climax Metals, Asarco, Phelps Dodge, Homebuilders of Central Arizona, Arizona Mining Industry Gets Our Support, Arizona Food Marketing Alliance, Arizona Association of Industries, Arizona Multihousing Association, Arizona Rock Products Association, Arizona Restaurant Association, Arizona Retailers Association, Boeing, Arizona School Board Association, National Federation of Independent Business, Arizona Hospital Association, Lockheed Martin, Abbot Labs, and Raytheon.

1 the Residential Utility Consumer Office ("RUCO"), and Arizona Community Action Association  
2 ("ACAA") (collectively, the "Parties"). The Settlement was the culmination of several months of  
3 negotiations between the Parties in which a compromise was reached with respect to many key  
4 issues that had been outstanding that, without resolution, would have been an impediment to the  
5 commencement of competitive retail access in Arizona. Although no particular Party can claim that  
6 it obtained everything it wanted in the Settlement, all of the Parties acknowledge that the Settlement  
7 is fair, reasonable and in the public's best interest.

8 TEP recognizes that although the Proposed Order adopts most of the provisions of the  
9 Settlement, the Proposed Order does recommend several modifications to the Settlement in an  
10 attempt not only to incorporate some of the positions of various Intervenors, but to conform the  
11 Settlement with some of the previous determinations of the Commission in the Arizona Public  
12 Service Company ("APS") Decision No. 61973 dated October 6, 1999. With respect to the latter,  
13 TEP does not agree that the Company's proposed Metering and Billing Credits should be modified  
14 just to be consistent with the APS Decision. However, as the Commission has already made this  
15 determination, without waiver or objection, TEP will not take up the Commission's time in formally  
16 arguing this issue herein.<sup>2</sup> There is, however, one proposed modification to which the Company  
17 takes strong exception. TEP believes that if this modification is adopted, the Company may have no  
18 choice but to withdraw the Settlement which would delay the implementation of Competitive Retail  
19 Access in TEP's service territory.

20 **II. THE DEPARTMENT OF DEFENSE'S ("DOD") METHOD OF STRANDED COST**  
21 **ALLOCATION ADOPTED IN THE PROPOSED ORDER IS NOT APPROPRIATE**  
22 **AND WILL RESULT IN AN UNDERRECOVERY OF STRANDED COST.**

23 A. The DOD has misapplied the stranded cost recovery mechanism in the  
24 Settlement as it relates to special contract customers.

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26  
27 <sup>2</sup> TEP presented evidence at the hearing that the Metering and Billing Credits were unbundled consistent with the  
28 Company's last two general rate cases and were based on average costs. The Commission required rate design to  
29 match cost of service, and that is exactly what TEP has done in establishing the proposed Metering and Billing  
30 Credits. The way these charges were unbundled is consistent with how all of TEP's rates and charges were unbundled  
for the Settlement pursuant to the Electric Competition Rules. To accept the modification set forth in the Proposed  
Order to artificially increase these credits, would single out these charges for unbundling in a manner that is  
inconsistent with the way TEP's other rates and charges have been unbundled and would violate the very basic  
premise that unbundled charges should sum to the bundled components.

1 It is unclear from the Proposed Order as to whether its intent is to adopt the DOD's method  
2 of stranded cost allocation as it relates to contract and non-contract customers. If the purpose is for  
3 TEP to simply file a report with the Staff to ensure that non-contract customers are not being  
4 required to pick up an alleged stranded cost shortfall from contract customers, TEP is willing to  
5 comply with this requirement as the allocation based upon the Settlement (and as more fully  
6 discussed below) will show that no subsidization exists. If, however, the intent of the modification  
7 in the Proposed Order is to make a determination that non-contract customers are picking up an  
8 alleged stranded cost shortfall from contract customers, TEP strongly objects to this modification to  
9 the Settlement for the reasons explained below.

10 On page 9, lines 2 through 8, the Proposed Order contains the following language:

11 Clearly, the non-contract customers should not be paying the stranded costs of  
12 contract customers. If there have been contracts entered into by TEP subsequent to its  
13 last rate case that have resulted in those contract customers paying less stranded costs,  
14 then TEP's shareholders should have to absorb those reductions. Similarly, if TEP  
15 did not increase the charges to contract customers by the 1.1 percent pursuant to  
16 Decision No. 59549, then TEP should absorb those costs. Those amounts, if any,  
17 should be reduced from the stranded costs paid by the non-contract customers.

18 There is clearly a misunderstanding with respect to contract rates effect on the rates of non-  
19 contract customers, as well as the Settlement's stranded cost recovery mechanism. All special  
20 contracts' discounts from the otherwise applicable tariff(s) entered into subsequent to TEP's last rate  
21 case are currently being borne by TEP's shareholders and have not been shifted to non-contract  
22 customers. Further, these costs will continue to be borne by shareholders through the proposed  
23 stranded cost recovery period for the following reasons: (i) the shortfalls associated with the above-  
24 mentioned special contracts have not been addressed in a general rate proceeding nor allocated to  
25 any other customer class; and (ii) they will not be addressed pursuant to the terms of the Settlement  
26 because the parties have agreed to a rate freeze during the stranded cost recovery period through  
27 2008.<sup>3</sup> Clearly, TEP's stranded costs as defined in the Settlement, did not increase as a result of  
28 special contracts. Rather, it appears that DOD's confusion arises from a misunderstanding of how  
29 TEP's estimates of stranded costs were determined. TEP did not calculate a level of stranded cost  
30

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<sup>3</sup> Subject to the provisions of Section 13.4 of the Settlement.

1 and then determine how that amount should be recovered from its customers. It developed a  
2 mechanism that balances many factors including no rate increases for any customers during the  
3 recovery period. Further, the Commission's Electric Competition Rules and the Settlement set the  
4 limit of recovery from contract customers at their current contract rate. The Settlement is also  
5 consistent with the Commission's Stranded Cost Order which states that "no customer or customer  
6 class shall receive a rate increase as a result of stranded cost recovery by an Affected Utility." The  
7 mechanism that was developed simply utilizes the current rates for each customer class and subtracts  
8 the MGC (and related adders) and other tariff components. Any resulting differential is CTC  
9 recovery.

10 TEP's estimate of stranded costs is \$683 million, based on the methodology discussed above  
11 and adopted in the Settlement (previous to the adder adjustment). TEP did not utilize the  
12 methodology suggested by DOD to arrive at the estimate. The estimate is based upon certain energy  
13 price assumptions that allows a portion of the CTC to float inversely to the market price of power.  
14 The CTC is thus calculated based on current prices allowed to be charged to customers pursuant to  
15 prior Commission orders and special contract prices approved by the Commission. This estimate is  
16 dependent on the underlying assumptions of what the market price will be over the term of the  
17 recovery period and the current prices allowed to be charged to customers. If these assumptions  
18 change, the amount of stranded cost would change. If the actual market price is higher than the  
19 estimate or customer pricing is lower in the Settlement, then stranded costs will be lower than \$683  
20 million. Conversely, if the actual market price is lower than the estimate, then stranded costs will be  
21 higher.

22 Clearly, as a result of the methodology discussed above, the allocation issues that DOD and  
23 the Proposed Order address are already removed from the recovery estimates. Moreover, each  
24 customer will only contribute to stranded costs in the proper proportion of the applicable tariffed and  
25 contract rates for which there are no subsidies.

26 The DOD proposal calls for TEP to forego recovery of a portion of the stranded cost. The  
27 Settlement proposal developed by the Company and the Parties defined stranded cost as the lowest  
28 amount that would provide sufficient recovery for the Company to avoid immediate write-offs of  
29 generation costs and regulatory assets. Designating a portion of those costs as not recoverable  
30 causes those costs to no longer represent assets, and such costs would have to be written off. The

1 Company has previously incurred significant write-offs of costs related to generation assets, and the  
2 remaining costs were deemed to be prudent in prior rate orders. The Company should not be  
3 requested to endure further write-offs when those costs have been previously authorized by the  
4 Commission. TEP notes that its shareholders have absorbed the discounts in reduced rates over the  
5 stranded cost recovery period for its contract customers. This was, in part, to keep special customer  
6 contract customers on TEP's system which was to the benefit of all of TEP's other customers. If this  
7 modification is adopted, TEP will have to write-off an additional \$40 to \$50 million. This is clearly  
8 not acceptable.<sup>4</sup>

9 B. Adoption of the DOD modification by the Commission would result in  
10 disparate treatment between TEP and APS.

11 As briefly discussed in the Introduction, is clear that the intent of the Proposed Order is to  
12 require modifications to the Settlement consistent with the modifications to the APS settlement in  
13 Decision No. 61973. This is either expressly stated or implied in several sections of the Proposed  
14 Order. This includes the adoption of the Staff recommendations on the Metering and Billing Credits,  
15 the revisions to "binding language" set forth in Section 14.3, the requirement to file a revised Code  
16 of Conduct and the filing in relation to the transfer of generation assets. Although the issue raised by  
17 the DOD was not part of the APS proceeding, the fact is that like TEP, APS also has special contract  
18 customers. The ratemaking treatment that the Commission has applied to those APS special  
19 contracts has always been consistent with the ratemaking treatment applied to TEP's special  
20 contracts. If the proposed modification was adopted, this would result in the Commission treating  
21 TEP's recovery of stranded costs under its Settlement, differently than what it required of APS under  
22 its settlement. While APS would have an opportunity to collect all of its requested stranded costs  
23 irrespective of their decreases and special contract customers, TEP would not be afforded the same  
24 opportunity. If it is the intent of the Proposed Order to essentially treat the Affected Utilities in a  
25 like fashion, this modification should not be adopted.

26 C. TEP's Proposed Amendments to the Proposed Order.<sup>5</sup>

27 TEP believes that the following amendments to the Proposed Order are appropriate and  
28

29 <sup>4</sup> TEP has already agreed to increase the adder by 20 percent which will result in its customers receiving an additional  
30 approximately \$32 million benefit and a corresponding reduction in stranded cost recovery to the Company.

<sup>5</sup> Additionally, page 18, line 14, delete "Pinal" and insert "Pima."

1 would alleviate the concern expressed hereinabove:

2 **Delete** lines 2 through 14 on page 9 and **replace** with the following:

3 Based upon the evidence presented at the hearing, we find that TEP's  
4 stranded cost recovery methodology and the corresponding unbundled distribution  
5 tariffs are consistent with A.A.C. R14-2-1607(G) and the Commission's Stranded  
6 Cost Order.

7 **Delete** lines 13 through 16 on page 22.

8 **III. CONCLUSION**

9 The Parties to the Settlement have negotiated a delicate balance to ensure benefits to all  
10 TEP's customers while permitting TEP a reasonable opportunity to recover its stranded cost. The  
11 proposed modification to the Settlement discussed herein will undermine that balance. Moreover, it  
12 will result in TEP improperly absorbing significant additional amounts of stranded costs that are  
13 already being borne by shareholders and have already been accounted for in the Settlement and in  
14 TEP's existing rates. The DOD's suggestion that TEP should forego what DOD mistakenly believes  
15 to be the stranded costs shortfall from special contract customers, is inconsistent with TEP's ability  
16 to have a reasonable opportunity to recover its stranded costs. Moreover, such an adjustment is  
17 inconsistent with the Electric Competition Rules, the Commission's Stranded Cost Order and the  
18 Commission's previous decision in the APS proceeding. Finally, DOD's analysis concludes that  
19 non-special contract customers are paying more for stranded costs when this is simply not true.

20 Based upon the foregoing, TEP respectfully requests that the Commission not adopt the  
21 proposed modification which will remove the last impediment to bringing Competitive Retail Access  
22 to TEP's customers.

23 **RESPECTFULLY SUBMITTED** this 4th day of November, 1999.

24 **TUCSON ELECTRIC POWER COMPANY**

25  
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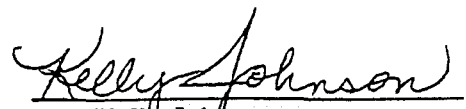
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